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# TRANSNATIONAL CORPORATIONS IN SERVICES, INCLUDING BANKING

## Issues related to the liberalization of foreign direct investment in services

## Report of the Secretary-General

**SUMMARY**

Services have maintained their role as the largest and fastest growing sector in both the flows and stocks of foreign direct investment, mainly as a result of investment among developed countries. Although foreign direct investment in services in the largest host developing countries has also grown the fastest, manufacturing remains the largest foreign-direct-investment sector in those countries. Foreign direct investment in services is likely to continue to grow rapidly and extend into such capital-intensive service industries as telecommunications and air transport in both developed and developing countries.

Foreign-direct-investment policies in services are being increasingly liberalized as a policy means to increase the efficiency and competitiveness of local service industries. Typically, this involves a move from the use of prohibitive instruments towards more open and liberal entry policies. More generally, it is often possible to find less restrictive, non-prohibitive measures, such as joint-venture requirements, which meet strategic or other non-economic objectives while at the same time, permitting local service industries to take advantage of foreign direct investment. As the experience of many countries with the liberalization of financial services shows, the opening of key services may lead to productivity gains that can improve overall economic performance.

* E/C.10/1993/1.

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## INTRODUCTION

1. At its eighteenth session, the Commission on Transnational Corporations requested that a report on transnational corporations in services, including banking, be prepared for consideration at its nineteenth session. This report has been prepared in response to that request. It analyses recent trends in foreign direct investment in services, including banking and other financial services, and examines issues related to the liberalization of foreign direct investment in services.

2. Recent policy developments and pronouncements suggest that a large number of developing countries have become genuinely interested in the development of a more efficient services sector or, at a minimum, in the improvement of selected service industries, primarily infrastructure and producer services. To achieve these objectives, countries are pursuing such policies as greater reliance on market forces, privatization of State-owned service companies and liberalization of international service transactions, especially the liberalization of foreign-direct-investment policies. Policy makers from developing countries are calling for a more efficient services sector, while central bankers underline the need for efficient financial services. A number of countries are doing what, a decade ago, would have been unthinkable: they are permitting transnational corporations into their financial, air-transportation, telecommunication and utilities industries.

3. These developments are occurring independently of the ongoing multilateral negotiations on international transactions in services. 1/ Still, while some developing countries are experimenting with unilateral liberalization, others are doing so within the framework of regional arrangements. For yet others, however, calls for action do not go much beyond declarations, perhaps because they are not certain about how to go about improving efficiency or because they become entangled in the political conflicts created by the issue itself.

4. The concern for greater efficiency in services results from the growing awareness of the role of services in the development process. Factors that are behind this growing awareness include the increasing contribution of services to employment and output generation, their interlinkages with other activities, the experience of developed countries with services deregulation and the impact of computer and communications technologies on a number of service industries. In addition, several developing countries have become keenly aware of the importance of such services as tourism, labour services, harbour services or transit-trade services, because, inter alia, they are hard currency earners or, in the case of producer services, they are basic for any efficient and competitive economy. Indeed, contrary to conventional wisdom, which sees growth in services mostly as a consequence of overall economic growth, there is a growing body of evidence suggesting that the development of certain service activities may not be a result of growth, but rather one of its preconditions.

5. Although there is a strong case on efficiency grounds for adopting liberal policies - policies providing for free and equal access of all qualified providers or suppliers, including foreign providers of services, to a country's market - cases of market failure as well as development considerations may justify policy intervention to regulate all providers and in some cases restrict

the provision of services by foreign firms. Many countries thus implement measures of one kind or another that limit foreign providers' access to and competition in their national markets for services.

6. The distinctive aspect of services as compared with goods is that the simultaneous presence of producer and consumer at the location of consumption and production is necessary for most services. Arm's length exchanges or pure cross-border trade of services between producers and consumers located in different countries is therefore very limited. Service producers of one country can generally sell services to consumers in another country only through the establishment of a production facility; the establishment of a commercial office performing tasks that fall short of production but without which the provision of the service would be impossible; the temporary movement of service-production personnel; or the temporary travel of foreign consumers to the producer's country. Among these various modes of delivering services to foreign markets, foreign direct investment is the most important one. Accordingly, any review of policies affecting international transactions in services must necessarily begin, not with trade policies, which have traditionally been the focus of commercial policy discussion in the context of international merchandise transactions, but rather with foreign-direct-investment policies and policies related to the movement of personnel and consumers between countries.

7. Chapter I provides an overview of recent trends in foreign direct investment in services, including financial services industries. Chapter II provides a discussion of the issues related to liberalization of foreign direct investment in services, based on the text prepared jointly by the Transnational Corporations and Management Division of the United Nations and the World Bank for a publication entitled Liberalizing International Transactions in Services: A Handbook; the Handbook is the first output of a joint project between these institutions and the United Nations Development Programme on the expansion of foreign direct investment and trade in services (EFDITS) (see box below).

Box 1. Joint Transnational Corporations and Management Division/World Bank/United Nations Development Programme technical assistance project on the expansion of foreign direct investment and trade in services

Awareness about the contribution of services to economic development among policy makers has grown enormously in recent years. The negotiation of a General Agreement on Trade in Services (GATS) within the context of the Uruguay Round is an important factor that has contributed to this new attention for services. If and when GATS is adopted, a comprehensive framework for the liberalization of investment and trade in services will be put into place. Independently of GATS, however, the recognition that the international competitiveness of domestic producers is increasingly linked to their access to a modern infrastructure of producer services is another factor that has brought services issues to the fore of the policy agenda.

Increasing the effectiveness of the contribution of services to economic development raises a number of conceptual and practical questions. If effectiveness is to be improved in part through promoting greater competition in services industries, which itself may improve efficiency of producers and a better allocation of resources throughout the economy, at what point does the need for greater competition and the need for regulation conflict with each other? Do the goals of efficient producers and an efficient allocation of resources conflict with development objectives? What can be the contribution of foreign service providers to efficiency and development objectives? What are the costs or benefits of liberalizing market access for foreign service providers, be it through foreign direct investment or through trade? Is the nature of the trade-offs between foreign direct investment and trade the same in services as it is in goods? If warranted, how should liberalization of market access for foreign service firms be structured and implemented? What do liberalization and efficiency mean in the context of various market situations in different service industries with varying degrees of tradability and in countries at different levels of development?

Few answers to these questions are readily available. Unlike the case of goods, which economists have debated for years and for which a 40-year track record of experience with trade liberalization exists within the framework of the General Agreement on Tariffs and Trade (GATT), there is little accumulated experience of a research or practical nature at hand to guide action.

Within this context the Transnational Corporations and Management Division of the United Nations Department of the Economic and Social Development and the International Trade Division of the World Bank, with support from the United Nations Development Programme (UNDP), have embarked on a technical assistance programme for developing countries designed to address some of the above-mentioned issues. In its pilot phase, the expansion of foreign direct investment and trade in services (EFDITS) project is being implemented in four countries that have requested assistance: Thailand, Tunisia, Uganda and Uruguay. It seeks to provide advice on policy formulation in the area of services liberalization and support for follow-up implementation. Implementation follows the preparation of a joint United Nations-World Bank publication Liberalizing International Transactions in Services: A Handbook and a project operating plan that are used as guides to the development of the programme at the country level.

# I. RECENT TRENDS IN FOREIGN DIRECT INVESTMENT IN SERVICES

## A. Overall trends

8. During the late 1980s and early 1990s, services maintained and in some cases even reinforced their role as the largest sector in both the flows and stocks of foreign direct investment. By the early 1990s, their share in world stock was close to 50 per cent, and they accounted for some 55 to 60 per cent of annual flows. 2/ Although foreign direct investment in services has increased in absolute terms in both developed and developing countries, it has done so much faster in the former than in the latter. For example, by 1990-1991 the stock of foreign direct investment in the services sector was the largest sectoral stock in both the outward and inward investment of 8 out of 11 developed countries (or in the case of 16 out of 22 observations concerning both outward and inward stock); the same was the case in only 3 out of the 16 largest host developing countries. 3/ The flow figures reflect exactly the same picture.

9. It is not clear whether if the relatively lower level of foreign direct investment in services in developing countries is due to restrictive policies towards transnational service corporations or to the lack of locational advantages. To the extent that the former is the case, the countries involved may be depriving themselves of an important growth factor, to say nothing of foreign-direct-investment inflows, the majority of which, world wide, go to service industries.

10. Table 1 shows that, for the 10 largest home countries, the outward stock of foreign direct investment in services amounted to $726 billion in 1990, or 50 per cent of their total foreign-direct-investment stock. Their average annual services outflows were $97 billion during 1988-1991, or 55 per cent of their total annual outflows. The United States of America, traditionally the largest outward investor in services, with a stock of $223 billion in 1991, has been overtaken by Japan, which has emerged as the largest new investor in services, increasing its stock by $189 billion, or four and a half times, between 1985 and 1991, to achieve a total stock of $232 billion.

11. Developed countries are also the largest host countries for services foreign direct investment. The stock of investment in services in the 10 largest developed host countries was $500 billion in 1990, accounting for 48 per cent of their total stock (see table 1 below). In the 16 largest host developing countries, the value of the stock in services was $62 billion in 1990, or 30 per cent of their total inward foreign direct investment. As mentioned earlier, in most developing countries the manufacturing or primary sector, rather than the services sector, has been the largest sector for inward investment.

12. Finance, insurance and trading have attracted the largest share of foreign direct investment, dominating the outward stock of investment in services in 13 out of 16 developed countries and the inward stock in 17 out of 22 developed countries. 4/ In the developing countries the picture is more varied. For example, among 15 Asia and Pacific countries, finance and insurance combined is the largest foreign-direct-investment recipient in 4 countries, while trading services is the largest recipient in 3 countries. 5/

Table 1. Sectoral distribution of foreign-direct-investment stock for the largest developed home countries and the largest developed and developing host countries, 1980-1990

| Group of countries and sector | 1980 | 1985 | 1990 | 1980-1985 | 1985-1990 | 1980-1990 |
|---|---|---|---|---|---|---|
| | (Billions of dollars) | | | Average annual growth rate (percentage) | | |
| Outward stock | | | | | | |
| Developed countries a/ | | | | | | |
| Primary | 88 | 115 | 160 | 5.5 | 6.8 | 6.1 |
| Secondary | 210 | 251 | 574 | 3.6 | 18.0 | 10.5 |
| Tertiary | 179 | 268 | 726 | 8.4 | 22.1 | 15.0 |
| Total | 477 | 634 | 1 460 | 5.7 | 18.2 | 11.8 |
| Inward stock | | | | | | |
| Developed countries b/ | | | | | | |
| Primary | 18 | 39 | 94 | 16.6 | 19.0 | 17.8 |
| Secondary | 148 | 195 | 439 | 5.6 | 17.6 | 11.4 |
| Tertiary | 102 | 188 | 499 | 13.1 | 21.1 | 17.3 |
| Total | 268 | 422 | 1 032 | 9.5 | 19.6 | 14.5 |
| Developing economies c/ | | | | | | |
| Primary | 17 | 31 | 46 | 13.6 | 8.6 | 10.8 |
| Secondary | 41 | 64 | 102 | 9.4 | 9.8 | 9.7 |
| Tertiary | 17 | 34 | 62 | 14.4 | 12.5 | 13.5 |
| Total | 75 | 129 | 210 | 11.6 | 10.1 | 10.9 |

Source: United Nations, Department of Economic and Social Development, Transnational Corporations and Management Division, database on foreign direct investment.

a/ Australia, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, United Kingdom of Great Britain and Northern Ireland and the United States of America.

b/ Australia, Canada, France, Germany, Italy, Japan, Netherlands, Spain, United Kingdom of Great Britain and Northern Ireland and the United States of America.

c/ Argentina, Brazil, Chile, China, Colombia, Hong Kong, Indonesia, Republic of Korea, Malaysia, Mexico, Nigeria, Philippines, Singapore, Taiwan Province of China, Thailand and Venezuela.

13. The historical country and industry pattern of foreign direct investment in services has been largely determined (and therefore distorted) by restrictive policies regarding such investment in many developed and developing countries, in contrast to less restrictive policies regarding foreign direct investment in manufacturing. History therefore reflects neither the relative propensities of individual service industries to transnationalize nor the locational advantages of countries regarding services foreign direct investment. This is rapidly changing, however; countries are opening up their service industries to various forms of foreign direct investment and services are becoming, for the first time, a routine subject of negotiations and liberalization agreements, treated in the same way as goods have been treated for many decades.

14. The internationalization of service industries through foreign direct investment is still in its early phases. It is therefore quite likely that the momentum of the growth in services foreign direct investment will be maintained or even increased during the 1990s. 6/ For one thing, demand for modern producer services, supplied mostly by transnational corporations, is growing rapidly in all countries, including developing countries. In addition, the countries of Central and Eastern Europe, in the transition towards a market economy, will need to make increasing use of such services as banking, insurance and other financial services, telecommunications, accounting and legal services. Countries also realize that the provision of many of those services will not be possible without the participation of transnational corporations. Moreover, the process of liberalization of foreign direct investment in services is a relatively recent phenomenon and is spreading to more countries as well as to more industries, including capital-intensive infrastructure services, such as telecommunications, transportation and public utilities, in which neither local nor foreign private ownership was previously allowed by most developed and developing countries, on the grounds of strategic considerations. Therefore, opening up to foreign direct investment in these industries, in most cases in the form of joint ventures, has been closely related to privatization programmes undertaken by many developed and developing countries. International transactions in services, including foreign direct investment, have also been liberalized within regional integration schemes in Europe (within the Single Market programme) and North America (United States-Canada agreement and the proposed North American Free Trade Agreement (NAFTA)).

15. Furthermore, transnational service corporations as a group are much less transnationalized than industrial firms, implying that there is considerable potential for rapid growth in services foreign direct investment in the future, especially in capital-intensive, technology-intensive and marketing-intensive industries, such as telecommunications and air transportation. It is quite possible that foreign direct investment in these two industries is already accelerating as a result of recent policy changes and that the available data (see table 1 above) do not yet reflect this acceleration. For instance, in 1991-1992 numerous agreements were concluded between airlines of different countries and many are still under negotiation, suggesting that a massive reorganization of the world airline industry through foreign direct investment is taking place. Similarly, the telecommunication industry has just been opened to large-scale foreign direct investment and is undergoing restructuring on a global scale. In addition, in service industries that are already transnationalized to a certain extent, such as banking and insurance, there is considerable potential for growth of foreign direct investment, as its

liberalization is extended through regional integration schemes or as new home countries emerge as large investors (see sect. I.B below on financial services).

16. While there is little doubt that these and other factors will lead to an increasing transnationalization of service industries in the near term, technological developments may, in the longer run, alter the ways in which services are delivered to foreign markets. The limited tradability of many services has been a key factor favouring the rapid growth of foreign direct investment rather than trade. The advent of transborder data flows through the convergence of computer and telecommunications technologies changes this situation fundamentally, because transborder data flows permit instantaneous, long-distance, interactive transactions via transnational computer-communication systems. 7/ By collapsing time and space, transborder data flows make it possible for certain services to be produced in one place and consumed in another. The result is an increased transportability and, therefore tradability of certain services, especially information-intensive services, which may reduce the need for foreign direct investment to deliver those services to foreign markets. Alternatively, transnational service firms may be prompted to split their production processes into parts and, like their manufacturing counterparts, to allocate certain labour-intensive operations to foreign affiliates in order to take advantage of lower wages and other costs; that would result in both increased foreign direct investment and intra-firm trade in services. In conclusion, although the precise nature of the new technological opportunities and their full implications is still far from clear, there is little doubt that they will act in favour of a continued expansion of foreign direct investment and trade in services.

## B. Financial services

17. As noted previously, the financial services industry is attracting one of the largest shares of outward as well as inward foreign direct investment in services of developed countries: the investment stock in financial services in developed host countries has increased at an average annual rate of 21 per cent during 1980-1990 (see table 2), compared to an average annual rate of 14.5 per cent for the stock of foreign direct investment in services as a whole (see table 1). The United States of America and Japan dominated outward investment stocks over the same period, while the United States and United Kingdom were the largest host countries for inward investment in financial services (see table 3).

18. In the developing countries, which are overwhelmingly host rather than home countries, the picture is mixed: the rate of growth of inward foreign direct investment in financial services in the major host countries during 1985-1990 rose slightly as compared with that in 1980-1985 (see table 2), but was lower than that of services taken as a whole in both sub-periods. Consequently, the share of financial services in total foreign direct investment in services declined during 1980-1990 (see table 2). In two major host countries, Brazil and Chile, however, foreign-direct-investment stock in financial services has grown more rapidly than the overall stock in services. 8/

Table 2. Foreign direct investment in financial services including banking, stock, 1980-1990

(Billions of dollars and percentage)

| | 1980 | 1985 | 1990 | 1980-1985 | 1985-1990 | 1980-1990 |
|---|---|---|---|---|---|---|
| Outward stock | | | | | | |
| Developed countries a/ | | | | | | |
| Value | 63.0 | 116.2 | 356.0 | - | - | - |
| Share in total services stock | 35.3 | 43.4 | 49.0 | - | - | - |
| Average annual rate of growth | - | - | - | 13.0 | 25.1 | 18.9 |
| Inward stock | | | | | | |
| Developed countries b/ | | | | | | |
| Value | 28.4 | 60.7 | 187.1 | - | - | - |
| Share in total services stock | 27.9 | 32.3 | 37.6 | - | - | - |
| Average annual rate of growth | - | - | - | 16.4 | 25.3 | 20.8 |
| Developing countries c/ | | | | | | |
| Value | 3.3 | 4.6 | 6.8 | - | - | - |
| Share in total services stock | 32.6 | 25.0 | 22.5 | - | - | - |
| Average annual rate of growth | - | - | - | 6.9 | 8.1 | 7.5 |

Source: United Nations, Department of Economic and Social Development, Transnational Corporations and Management Division, foreign-direct-investment database.

a/ Australia, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, United Kingdom of Great Britain and Northern Ireland and the United States of America.

b/ Australia, Canada, France, Germany, Italy, Japan, Netherlands, Spain, United Kingdom of Great Britain and Northern Ireland and the United States of America.

c/ Argentina, Brazil, Chile, China, Colombia, Republic of Korea, Malaysia, Philippines, Thailand and Venezuela.

Table 3. Foreign direct investment in finance and insurance in the largest home and host countries, 1980-1990

(Billions of dollars)

| Country | Outward stock | | | Inward stock | | |
|---|---|---|---|---|---|---|
| Developed countries | 1980 | 1985 | 1990 | 1980 | 1985 | 1990 |
| United States | 34.5 | 57.4 | 130.3 | 12.0 | 27.4 | 63.1 |
| Australia a/ | 2.1 | 2.2 | 12.2 | 2.3 | 5.7 | 27.9 |
| United Kingdom | 0.2 | 8.3 | 22.4 | 0.7 | 5.2 | 27.4 |
| Italy | 1.4 | 6.6 | 25.1 | 0.9 | 4.2 | 23.7 |
| Canada | 3.1 | 9.2 | 19.1 | 6.5 | 10.2 | 21.4 |
| France | 2.5 | 5.7 | 19.5 | 1.7 | 2.2 | 16.5 |
| Spain | .. | .. | .. | .. | 1.1 | 11.4 |
| Germany | 4.6 | 8.8 | 21.8 | 2.9 | 3.6 | 9.2 |
| Netherlands | 1.6 | 5.7 | 16.1 | 1.3 | 2.1 | 6.6 |
| Japan | 2.4 | 10.8 | 65.3 | .. | .. | 0.7 |
| Developing countries | | | | | | |
| Brazil | .. | .. | .. | 0.7 | 1.1 | 2.3 |
| Chile | .. | .. | .. | 0.1 | 0.5 | 1.2 |
| Malaysia | .. | .. | .. | 1.4 | 1.6 | 1.4 |
| Argentina | .. | .. | .. | 0.5 | 0.8 | 0.8 |
| Thailand | .. | .. | .. | 0.1 | 0.1 | 0.4 |
| Colombia | .. | .. | .. | 0.1 | 0.2 | 0.2 |
| Philippines | .. | .. | .. | 0.2 | 0.3 | 0.2 |
| Republic of Korea | .. | .. | .. | 0.1 | 0.2 | 0.3 |
| China | .. | .. | .. | .. | 0.1 | 0.1 |
| Venezuela | .. | .. | .. | 0.2 | 0.1 | 0.1 |

Source: United Nations, Department of Economic and Social Development, Transnational Corporations and Management Division, foreign-direct-investment database.

a/ Including finance, property and business services.

19. Evolving strategies of transnational banks and other financial enterprises, as well as changing host country demand conditions and policies with respect to financial services, lie behind the acceleration of foreign direct investment in the industry in recent years. As regards transnational corporations strategies, most internationally operating financial institutions, including banks, insurance companies, securities houses and other financial services firms, have continued or resumed their efforts, which date from the 1960s and 1970s, to expand their international operations through foreign direct investment and cross-border transactions. However, although they still continue to serve the foreign affiliates of their home country corporate clients, their motivations now include actively making inroads into the domestic markets proper of their host countries. 9/ Two major trends have emerged in this respect. The first is the striking increase in international securities-related services provided through the establishment of affiliates in the main foreign securities markets as well as in a number of smaller countries with emerging capital markets; recent United States data showing the growth of finance other than banking relative to other categories seem to illustrate this trend (see table 4). The second is the attempt by banks and other financial institutions to expand their operations in the markets of their host countries via cross-border mergers and acquisitions, a strategy being applied in particular in the European Community, in response to the emerging unified market for financial services. 10/

Table 4. Composition of United States of America outward foreign-direct-investment stock in financial services, by category, 1987-1991

(Billions of dollars)

| Category | 1987 | 1988 | 1989 | 1990 | 1991 |
|---|---|---|---|---|---|
| Banking | 18.0 | 19.1 | 19.1 | 19.8 | 18.8 |
| Insurance | 11.6 | 13.2 | 14.2 | 16.1 | 16.3 |
| Finance (except banking) | 5.0 | 10.8 | 23.5 | 29.4 | 28.6 |
| Holding companies | 34.5 | 37.5 | 57.1 | 65.0 | 70.1 |
| Total, above | 69.1 | 80.6 | 113.9 | 130.3 | 133.8 |

Source: United States Department of Commerce, Survey of Current Business, August 1989 and August 1992.

20. Recent liberalization efforts by developed and developing countries have provided an environment conducive to the expansion of foreign direct investment in financial services. In developed countries, a major factor has been the amendment of the Organisation for Economic Cooperation and Development (OECD) Capital Movements Code in 1986 to include new provisions that strengthen liberalization obligations regarding the creation of transnational bank branches and agencies or other forms of establishment in the banking and financial services industry. The amendment extended to these forms of

foreign-direct-investment obligations already in force with regard to subsidiaries, regarding freedom of establishment, non-discrimination with respect to activities and national treatment. 11/

21. In developing regions, several countries in Latin America (including Argentina, Brazil, Mexico and Colombia) have liberalized to varying degrees rules relating to foreign investment in banking and other financial services. Asian countries such as India, Indonesia, the Lao People's Democratic Republic, Malaysia, Pakistan and the Republic of Korea have also revised their regulations to ease entry and/or ownership by transnational corporations of affiliates in banking and/or securities-related services in their economies. 12/ Several African countries which are looking for ways to attract foreign direct investment may also need to pay special attention to the improvement of the efficiency of their financial services through financial reform, including policies allowing greater participation of foreign financial firms. Growing demand for efficient and sophisticated financial services and privatization due to, inter alia, capital constraints faced by Governments, have strengthened the movement on the part of developing countries, towards liberalization in this industry, while the profitability of transnational bank operations in those economies that were already open to foreign financial firms, such as Hong Kong and Singapore, has increased due to rapid growth of domestic demand. 13/

## II. ISSUES RELATED TO THE LIBERALIZATION OF POLICIES CONCERNING FOREIGN DIRECT INVESTMENT IN SERVICES

### A. Introduction

22. The types of foreign direct investment through which services can be delivered abroad range from wholly owned affiliates of transnational corporations to joint ventures and non-equity arrangements. The last of these include such arrangements as professional associations (partnerships), franchises and management contracts, which are widely used in some service industries. Each of these forms satisfies the defining characteristic of foreign direct investment, namely that a firm in one country controls assets in another country.

23. Foreign direct investment and transactions associated with such investment can be promoted, contained or altogether prohibited by a variety of measures, ranging from direct regulations concerning the entry, establishment and activities of foreign companies (foreign-direct-investment policy proper) to broader rules on capital movement, foreign exchange or taxation. These measures can be grouped into three broad categories of instruments:

(a) Instruments relating to market access. These primarily regulate the entry and establishment of foreign companies in a host country. They range from bans on entry, that is, the total prohibition of foreign companies or the prohibition of certain types of operations or forms of investment, to complete freedom of entry and establishment. Limits on the level of foreign equity invested in domestic companies, for example, 49 per cent or less, also belong to this category, as do limits on the number of foreign firms in a market or industry or limitations on the geographical scope of their activities;

(b) Instruments relating to standards of treatment. These include a spectrum of instruments determining the extent to which foreign firms receive treatment that differs from that accorded to domestic firms. These instruments may affect such areas as taxation, foreign exchange, borrowing, access to local markets and inputs, and exports and imports, and may be important enough to have a significant influence on the decision of foreign investors to invest or divest. For example, rules relating to external financial transfers or taxation are considered by most transnational corporations to be a crucial determinant of foreign direct investment;

(c) Other measures. These are measures which do not discriminate in theory between foreign and domestic firms but have that effect in practice. Important among them are instruments relating to the safety of assets and the right of exit of foreign companies, including protection measures and guarantees and rules governing expropriation, compensation and dispute settlement. Exit regulations may bear quite heavily on the decision by foreign investors to invest in a country. Instruments resulting from various areas of the general regulatory framework of a country can indirectly influence foreign direct investment and the activities of transnational corporations; they include such measures as the regulation of monopolies, competition policy, prudential regulations and consumer protection.

24. The present report focuses on issues related to the first category of measures and policies because total or partial prohibitions of foreign direct investment are still quite common in the service industries of developing and developed countries. While reviewing their policies, countries face issues related to the transition from a total prohibition of foreign companies, through the prohibition of certain types of investment and preference given to transnational corporations, to a wider opening of their service industries to foreign direct investment.

## B. Liberalization of prohibitive policies

### 1. Instruments of total and partial prohibition

#### Total prohibition of foreign direct investment

25. Total prohibition is a measure that excludes foreign firms or individuals from any participation in the domestic economy or some industries in the economy. It is the foreign-direct-investment policy equivalent of an embargo or zero quota on cross-border imports of a product. Use of this instrument can be intentional and transparent as, for instance, when a foreign-direct-investment law or a constitutional provision explicitly specifies areas from which foreigners are excluded. Or it can be hidden, as in the case of countries where no legal instrument or policy proclamation excluding foreign enterprises exists, and approval or denial of entry is a matter of discretionary administrative decisions.

26. Sometimes, a prohibitive or exclusive effect can be achieved in the absence of any formal government restriction or screening practice. For example, the presence of public or private monopolies in an industry excludes the possibility of entry by a foreign company. There may also be impediments of an informal or

structural nature that stem primarily from the business organization and culture of the country concerned. Japan and (to a lesser extent) Germany are examples of countries where inward foreign direct investment has been relatively weak despite a liberal investment regime.

Partial prohibition or limitations on certain types of investment

27. Prohibition does not have to be total but may be partial, through restrictions or limitations on some kinds of investment and preferences for others. Such limitations and preferences may apply as follows:

(a) Acquisition versus greenfield investment. Certain countries take a relatively liberal attitude towards the entry of foreign firms which establish new production facilities and are relatively restrictive towards the foreign acquisition of existing domestic enterprises. Restrictions may be enforced openly or indirectly; for example, merger-control provisions may be used to block acquisitions by foreign companies, even though they do not formally distinguish between domestic and foreign firms;

(b) Branches versus subsidiaries. Certain countries are reluctant to admit branch operations by foreign producers, while taking a more liberal attitude towards the establishment of subsidiaries. The reason is that the latter are separate legal entities incorporated under the laws of the host countries and therefore considered as local "corporate citizens";

(c) Equity versus non-equity forms of foreign direct investment. Countries that exclude equity participation may permit non-equity participation, such as licensing, franchising, management contracts and collaborative agreements. In many cases, the reason to prefer one form of participation over another is not clear and may vary according to industry or other circumstances. In the hotel industry, for example, the host country's preference for equity or non-equity forms (management contracts, franchising or technical assistance agreements) may depend on whether or not finance capital is available locally. 14/ Sometimes, instead of prohibiting foreign companies altogether from investing in an industry, countries may chose to prohibit forms of non-equity investment prevalent in the industry, such as franchising in the fast food and retail trade or management contracts in the hotel industry;

(d) Majority or wholly owned affiliates versus joint ventures. Some countries consider joint ventures as the preferable or even the only admissible form of foreign direct investment and require that a certain amount of equity (sometimes the controlling interest) be reserved for local investors. In this case, the prohibition of foreign enterprises is replaced by a limitation on the controlling share in equity ownership. As joint ventures represent forms of participation of transnational corporations that are of particular interest to developing countries and for certain service industries in both developed and developing countries, they are discussed separately in section II.C below.

Restrictions on the geographic location of foreign service affiliates

28. The entry of foreign firms may be restricted in terms of the geographical area in which firms are allowed to operate. This restriction is used frequently in banking, with many countries limiting the activities of foreign banks to the

country's largest business centre(s); but it may also be used across the board, as in China, where certain foreign firms are restricted to special economic zones.

Restrictions on the number of foreign firms

29. The entry of foreign firms may be limited to a fixed number of participants. Such quotas may be de jure or de facto as when a country refuses to issue new entry licenses to foreign firms. Open or hidden quotas are frequently used in banking, transportation, some professional services and other service industries.

## 2. Relevance to services

30. Outright prohibition of foreign companies was quite common two or three decades ago, especially in developing countries in the aftermath of decolonization and in socialist countries where a reliance on foreign capital was ruled out on ideological grounds. Today it is difficult to find any country that does not welcome foreign direct investment, at least in some industries. At the beginning of the 1990s, total prohibition tends to focus on a selected and declining number of industries which are considered to be important to national defence, national sovereignty or cultural identity; services figure prominently among them. They usually include most kinds of transportation (air, maritime and rail), broadcasting and media, telecommunications, public utilities and a number of professional services. In developing countries, the total exclusion of foreign firms (or the exclusion of controlling interests by foreign enterprises) has remained quite common in insurance, banking, advertising, retail trade and even tourism.

31. Instruments regulating certain key aspects of operations of foreign affiliates can be used in some service industries with a view to achieving a prohibitive effect. This may be the case with regulations related to the nationality and/or residence of the members of the board of directors of a service enterprise, its management and its employees. If requirements regarding local personnel, especially management, are considered by foreign investors as limiting their managerial capabilities, such requirements may negatively influence an investment decision or result in a withdrawal. In professional services which are normally provided by individuals, such as physicians, or partnerships, such as accountancy firms, a host country nationality requirement may also act as an absolute barrier to the establishment of foreign services providers. In many countries, admission to a professional association is a precondition to the practice of the activity and admission is often linked to citizenship or, at a minimum, to residence in the host country.

## 3. Elements for policy review and assessment

32. Where a Government pursues an objective that requires keeping foreign enterprises out, the advantage of prohibition, as a policy instrument, is its ability to deliver the desired outcome. The costs of such a policy include the possible loss of growth and efficiency, higher prices and lower productivity - in other words, the costs of protection. This general statement requires

qualification when applied to foreign direct investment in service industries, however:

(a) First, the economic cost of prohibition may be higher than it is in the case of goods in part because the intra-firm division of labour and intra-firm trade tend to be lower among transnational services corporations than they are among transnational manufacturing corporations. 15/ Foreign services affiliates are often miniature versions of their parent companies, rather than specialized elements in world-wide systems of production. The implication is that, for a given amount of foreign direct investment, investment in services tends to produce greater economic development benefits in terms of transfer of technology, skills, supply of unique services or productivity gains than the same amount of investment in manufacturing;

(b) Second, it is difficult to assess the costs and benefits of prohibiting foreign direct investment or other forms of participation by transnational corporations in the case of services, because the benefits quite frequently involve considerations other than strict economic efficiency, such as national sovereignty and cultural integrity. Such benefits are typically highly subjective and hard to measure in monetary terms. The costs, however, can be assessed in terms of lost efficiency, higher prices for users or lower economic growth.

33. Even though prohibitive or restrictive policies with respect to foreign direct investment and transnational corporations may be adopted in the pursuit of apparently sound objectives, these should periodically be re-examined for their usefulness. There are several reasons for such a re-examination. First, national objectives are not static and parameters defining their relevance may undergo substantial changes. For example, technological change may vastly increase the range of application of certain services and as a result move an industry from the margin to the centre of national interest, as has been the case for telecommunications in recent years. The availability, price and quality of telecommunications services affect so many other economic activities today that pressure on Governments to improve such services has increasingly overshadowed concerns about foreign presence. Second, with the advent of new decentralizing technologies (for example, home video and satellite transmissions), Governments may be losing their ability to keep whole industries or markets under their control, even if they were able to use quite efficient instruments of control in the past. Third, there is always the possibility that national defence or strategic importance arguments are being or have been used by established producers to protect widespread inefficiencies. It has been pointed out that national defence, like patriotism, may be the last refuge of those seeking selfish protection but willing to wrap the flag around their interests; this applies both to tariffs and to prohibitions against foreign direct investment in particular fields. 16/ It may also be that prohibition, although perhaps justified on national defence grounds, is quite liberally extended to industries or activities where it rather "smacks of protection, not national defense". 17/ And, last but not least, countries may gradually become less sensitive to a growing foreign presence in their economies because the cost of supporting too many inefficient national industries becomes too high and the positive experience of other countries with foreign enterprises becomes undeniable. Furthermore, many concerns related to the presence of transnational corporations often do not materialize. For example, in services such as

accounting, engineering or even banking, foreign companies, instead of crowding out local firms, often operate in market niches not competing directly with local firms.

34. If a country decides to continue with restrictions, the least it can do is to consider alternatives; there may be other, less costly and less prohibitive instruments for achieving the same objective. 18/ Total prohibition may be replaced by milder forms of limitations on foreign presence, such as minority joint ventures, which may be less costly in terms of technology transfer or access to capital. For example, joint ventures with a foreign partner in a telecommunications or public utility may be less costly than the absolute exclusion of foreign companies and exclusive reliance on domestic providers. Likewise, permitting limited activities of transnational services corporations operating in market niches and catering to the needs of transnational manufacturing corporations may be less costly than a total exclusion that could lead to more costly substitutes produced by indigenous firms.

35. Sometimes, economic considerations, such as those relating to the balance of payments, motivate severe restrictions in service industries, for example in the area of financial services. Foreign direct investment may be prohibited on the grounds that it is expensive, or it may be limited to export or import-saving industries to ensure that the transfer of profits and/or savings to foreign owners will not put undue burdens on the balance of payments. The policy assessment in this case is more straightforward, because the supposed expected benefit is economic in nature and should therefore be quantifiable. A narrow, one-industry approach to balance-of-payments problems is not appropriate, however. Rather, economy-wide effects of any restrictions should be taken into account. For instance, in the area of insurance services, the exclusion of foreign insurers and the requirement that primary insurance be bought only from domestic firms may lead to increased dependence on foreign reinsurance and a resulting increased outflow of reinsurance premiums. However, this outflow may be more than offset by the prompt payment of claims. 19/ If efficient producer services provided by transnational corporations enhance the export capacity of a host country, the indirect gains in export earnings may be significant and should be taken into account in any policy assessment concerning the presence or exclusion of foreign service companies.

36. If countries wish to depart from the policy of total prohibition of foreign companies in their service industries based on non-economic objectives but are not yet ready to grant the right of establishment to all foreign service producers, the choice of foreign-direct-investment instruments and forms and their policy assessment will depend on the policy objectives and the concrete situation in a specific service industry. No form of foreign direct investment should be *a priori* discarded as automatically harmful, or another preferred as automatically guaranteeing greater benefits. For example, takeovers and acquisitions of domestic companies are normally viewed with suspicion, as possibly resulting in anticompetitive behaviour, running counter to the industrial policy objectives of host countries and exacerbating fears of foreign dominance. In certain situations, however, they can be beneficial. Foreign participation in existing domestic firms may often be the only device available to enhance the efficiency of those firms or to rescue ailing enterprises by injecting new capital and know-how. In many countries, foreign participation through acquisition, in the absence of sufficient domestic savings, is

indispensable to the success of privatization programmes in capital-intensive services such as telecommunications or transportation. Acquisitions can also be used in the context of debt-equity conversion schemes, which may improve the external debt and payments situations of host countries while recycling resources for productive uses.

37. If the objective of a new policy is to achieve greater efficiency of a service industry through the establishment of a competitive environment, then discarding prohibitive foreign-direct-investment instruments should be part of a broader policy reform which, depending on the service industry, may include a number of accompanying measures, such as the privatization of domestic companies; market opening not only for foreign but for all companies; the strengthening or introduction of prudential regulations or other consumer-protection regulations; and the strengthening of anti-monopoly regulations. Such reform would take into account differences between service industries.

## 4. Experience

38. An analysis of experience in the use of market-access instruments can be undertaken from two perspectives. One perspective looks at countries or industries in which market-access restrictions have been applied for a long time and that are just beginning to open up their economies; this type of analysis focuses on the consequences of keeping foreign companies out. A different perspective looks at countries that lifted bans on the presence of foreign companies some time ago and have experienced foreign direct investment in services for a number of years. Both types of country experience provide strong evidence suggesting that high levels of protection of domestic services, combined with public ownership and excessive economic regulation, have been detrimental to the efficiency of the industries concerned and have imposed widespread costs on their domestic economies. Both also suggest that opening up to foreign direct investment can bring benefits to the countries concerned. This can be illustrated by examples from the financial sector in both developing and developed countries.

39. In India, foreign direct investment in the financial sector has remained tightly controlled and subject, until recently, to a 40 per cent ceiling on foreign equity participation. The profitability of banks has suffered through a combination of nationalization and the obligation to provide low-interest loans to priority sectors. 20/ To meet such requirements, banks had to fix interests rates on deposits far below market rates and thus have failed to mobilize domestic savings to the maximum extent possible. Similarly, Brazil's commercial banking, which faces significant regulation, has had one of the lowest efficiency indexes in Latin America. 21/ Yet both India and Brazil have large markets and an educated workforce. A relaxation of restrictions could result in considerable efficiency gains and growth in the banking industry, not only through the expansion of the national markets but also through its overseas expansion. Indeed, such changes began to occur in Brazil after 1990 and in India in 1992.

40. Australia and Spain are prominent examples of successful banking liberalizations among developed countries. In Australia, the deregulation of

the banking system, which began in the early 1980s, was accompanied by the licensing of 16 foreign commercial banks. This led to substantial inflows of foreign direct investment, which transformed the financial market. The entry of foreign banks provided more intensive competition and downward pressure on rates and profit margins. Fears that this would result in foreign dominance of the market-place did not materialize; two years after the entry of the foreign banks, the local banks still accounted for 90 per cent of total assets. 22/ While foreign banks, taken as a whole, are larger in size and more advanced in technology and financial techniques, domestic banks have extensive retail deposit bases and well-established relations with corporate customers, two important advantages in competing with foreign banking affiliates. In Spain, the experience with the liberalization of financial services has been equally positive. The competition and innovation fostered by foreign banks in a market that used to be characterized by some of the highest margins in Europe has brought significant benefits to consumers and corporate users and should serve as a catalyst for Spanish banks to become more competitive internationally.

41. Positive experiences with the liberalization of banking services are by no means confined to developed countries. Case studies of transnational banks and financial markets in developing countries have shown useful synergies between foreign and domestic banks. 23/ For example, one beneficial effect from opening the banking sector to foreign direct investment is an increase in financial flows, in particular the growth in syndicated loans that is facilitated by the presence of foreign banks. In developing countries with large domestic markets open to foreign banks, the use of modern payment instruments such as credit cards and cheques has become more widespread and local banks have been stimulated to use modern computer technologies. Concerns that foreign banks might end up dominating the domestic market have typically proven unwarranted. Instead, a complementary role has developed between foreign and domestic banks: while the former tend to focus on international transactions, wholesale banking and trade facilitation, the latter have continued to dominate retail banking. This complementarity of roles, in other words, this specialization, is not due to regulatory constraints but is largely the result of differences in comparative advantages between foreign and domestic banks. 24/

42. To sum up, it is probably almost always possible to find a less restrictive measure for preserving the national interest while at the same time taking advantage of foreign direct investment. The opening of key service industries may bring about productivity gains that may significantly improve overall economic performance. Import substitution policies based on restrictions on trade and investment, on the other hand, may entail high economic costs and harm the expansion of the national economy.

43. Another lesson from the experience of many countries is that liberalization measures need to be carefully designed, taking into account the effects of previous regulatory constraints on the domestic services industry. For instance, if the balance sheets of domestic banks are burdened with a large proportion of bad loans granted in accordance with instructions from government authorities, these banks cannot be exposed to foreign competition without prior measures to help them redress their financial situation. Under conditions of liberalization, unprofitable loans granted for social purposes should be subsidized out of government funds and not out of low-interest rates on

deposits. Where necessary, prudential regulations should be introduced or reinforced to increase confidence in the banking system. The privatization of government-owned banks could also help improve the efficiency of the national banking sector. In other words, the liberalization of services industries should be part of a broader design of financial sector reform.

### C. Liberalization of ownership-restriction policies

#### 1. Instruments and their relevance for services

44. Measures to restrict foreign ownership in the equity of enterprises, either across the board or in particular sectors or industries, constitute an important if specific group of foreign-direct-investment policy instruments. They prescribe a maximum limit for the share of equity that can be held by a foreign firm or individual, requiring, in effect, that foreign participation take the form of a joint venture involving host country nationals as shareholders. In contrast to the instruments discussed in section II.B. above, they do not limit the participation of (partly) foreign companies in an industry or market. In extreme cases, foreign companies may even dominate an industry, provided that local interests have a share of equity in the foreign affiliates involved. At another extreme, ownership restrictions may act as a deterrent to keep foreign companies out altogether.

45. There can be two distinct groups of reasons for imposing ownership restrictions. First, they can be used to ensure local or national control at the firm and/or industry level, with a view to achieving some of the non-economic objectives discussed in the preceding section. If ownership restrictions are used with this objective in mind, the permitted form of foreign direct investment is usually a minority joint venture. Second, they may aim at achieving economic objectives such as macroeconomic and monetary stability and consumer protection, on the grounds that it is easier to monitor and discipline nationally controlled enterprises, or to share benefits with local interests.

46. Across-the-board rules prescribing maximum foreign ownership of enterprises were contained in the regulations of some developing countries, as well as implicitly enforced in the screening procedures of some developed countries until the early 1980s. 25/ Although the prescription of ownership requirements for foreign direct investment generally has declined since the mid-1980s, a number of service industries have continued to be subject to ceilings on foreign ownership in developed and developing countries. Paradoxically, this can be largely explained by progress in the liberalization of services foreign direct investment, involving a movement from total prohibition to the opening up to foreign participation of various kinds as well as a movement from lower to higher permitted foreign equity levels. A number of Latin American countries, for example, have opened their telecommunications industries to transnational corporations, permitting minority foreign ownership in basic telecommunications and higher foreign ownership shares in value-added services; Singapore has increased the foreign equity shares permitted in banks from 20 per cent to 40 per cent; and Indonesia has announced plans for relaxing foreign ownership rules in banking. India has raised permitted foreign ownership of hotels from a minority share to over 51 per cent. Among developed countries, the United States has raised permitted foreign ownership shares in

air transportation and the United Kingdom in telecommunications firms. Given the currently increasing frequency of foreign direct investment in these two industries, joint ventures may become the norm in these industries in both developed and developing countries.

## 2. Elements for policy review and assessment

47. If the policy objective is non-economic or is related to monopoly and requires that domestic control be retained, then the conclusions from section II.B above apply here as well: joint ventures are a better instrument than prohibitions, especially in industries in which monopoly is the norm but which are in need of modernization, such as telecommunications, public utilities and rail transportation. If an industry includes many firms, however, domestic management and control of each and every enterprise is not necessary for avoiding dependence on transnational corporations; if there are no restrictions on entry, locally owned companies are likely to coexist with foreign affiliates, reducing the danger of dependence.

48. As far as economic objectives or benefits are concerned, it should first be noted that most of them are linked not so much to the local equity itself as to the management and control that this equity is supposed to provide. While it is correct that, in most cases, majority equity participation ensures control, in many other cases, involving a number of service industries, control can be exercised with low-equity shares or even without any equity and can be derived from non-equity arrangements.

49. Assuming, however, that majority ownership is sufficient for the control of an enterprise, a case for across-the-board joint ventures in preference to fully foreign-owned subsidiaries can be made if economic benefits of national control outweigh the costs. The major expected advantage of joint ventures is their greater contribution to the development of local entrepreneurship and to the acquisition of technology and skills by host country nationals. The expectation is that joint ventures, as well as non-equity arrangements, allow for a larger role for host country nationals than do fully foreign-owned affiliates; this, in turn, is expected to strengthen domestic entrepreneurial and technological capabilities through management control, training or interaction with expatriates. But this may not always be the case. It is less likely that it will happen in countries at an early stage of development, with weak domestic educational and technical endowments. Nor is it a realistic expectation in more sophisticated industries, either because transnational corporations are unwilling to provide more sophisticated technologies under non-equity or low-equity arrangements, or because local abilities to put the package together are less adequate, even in more advanced developing countries, the more sophisticated the technologies. Finally, whether a joint venture approximates more nearly a fully or majority foreign-owned subsidiary or an arm's length arrangement for the transfer of technology depends on the specific conditions of both the industry and the joint venture and the capabilities and bargaining power of the joint venture partners.

50. The principal economic costs of ownership restrictions, especially if they take the form of permitting minority foreign equity participation only, are related to the fact that they act as deterrents to foreign direct investment by

some potential investors. Costs include not only the reduction in capital flows that is likely to occur, but also the lack of access to the other contributions that may be associated with foregone investments, including access to sophisticated technology, which is generally associated with higher equity stakes by transnational corporations; access to markets, which would be important in export-oriented industries; and greater operational efficiency and competitive effects due to economies of scale and scope often enjoyed by transnational corporations.

### 3. Experience

51. The literature on industrial joint ventures, which is plentiful, in contrast to the dearth of literature on joint services ventures, suggests that minority foreign-owned or non-equity joint ventures do not necessarily or automatically guarantee certain benefits in terms of the transfer of skills and technology to a host country in distinction from majority or wholly foreign-owned affiliates. However, under certain conditions, joint ventures that are predominantly or wholly locally owned confer greater learning and more effective transfer of technology than firms with significant ownership and control by transnational corporations. 26/ This applies, however, only if the host country has already reached a certain degree of development and has the necessary abilities for technology absorption. 27/ The nature of the industry is also relevant, with transnational corporations being more reluctant to provide sophisticated technologies under low-equity or non-equity arrangements.

52. These general conclusions can also be applied to joint ventures in service industries. Whether joint ventures are the most appropriate form for the acquisition of technology and skills in services is likely to depend on the stage of development, the industry in question, and the negotiating capabilities of the parties concerned. It is also relevant to note that training is likely to be the most important channel for the transfer of services technologies and transnational corporations have been observed to perform adequately in this area, as distinct from research and development, technology choice and innovation. 28/ Thus, fully or majority-controlled affiliates may contribute more to the transfer of technology in service industries than in manufacturing. Much depends, however, on the circumstances, including the availability of locally educated specialists.

53. As for ownership restrictions acting as a deterrent to foreign direct investment, the experience is not unequivocal. Certainly, countries applying across-the-board ownership restrictions, such as India and the former centrally planned economies, receive relatively less foreign direct investment or hardly receive such investment at all. But these countries either have cautious attitudes to foreign direct investment in general or an attitude based on unrealistic expectations and ownership restrictions are merely one expression of this attitude. On the other hand, if the foreign-direct-investment climate is generally favourable, as for example in Thailand, local ownership requirements in service industries, such as advertising, hotels and entertainment, do not seem to have a substantial effect on foreign direct investment in these industries.

54. In some service industries, the experience of developing countries with joint ventures dates from the 1960s and 1970s, when a number of countries attempted to regain national control over their economies, including key services; in other industries, such as telecommunications, transportation and public utilities, which have recently embarked on a number of joint ventures, it is too soon to draw meaningful conclusions. Past experience, even though seemingly obsolete, may still be instructive, as an example from Morocco shows. Morocco was one of many developing countries in the early 1970s that undertook the "indigenization" of the local economy, then largely dominated by foreign capital (foreign companies controlled two thirds of the banking and insurance institutions). The effort, based on a 1973 law, provided for a transformation of foreign-owned companies into joint ventures in which Moroccan capital should hold at least 50 per cent equity. Following this law, the number of foreign companies was substantially reduced; in banking and insurance, the formal requirements were soon met, mainly through the restructuring of ownership in existing foreign companies, only a few of which withdrew at that time. Although the Moroccanization campaign was quickly abandoned, the majority local ownership provisions were retained in the case of banks and insurance companies. However, despite these provisions, effective control has frequently remained with foreign partners, due to two factors. First, Moroccan administrators could delegate their power to foreign personnel holding managerial positions, an option widely used due to the lack of skilled local personnel able to deal with complex financial transactions. And second, it was necessary to avoid conflicts with foreign partners in order to ensure the transfer to local personnel of know-how and training in sophisticated financial techniques. 29/

## D. Conclusions and policy recommendations

55. In assessing the usefulness of prohibitive instruments regarding foreign direct investment in service industries, policy makers should take into account a number of considerations, many of which are common to any policy review. They should clearly identify the objectives of their policies and examine their validity and cost to consumers, producers and the Government. Objectives should be clearly stated and regularly re-examined. Policy makers should examine the instruments currently being used to see if there are less restrictive and less costly instruments that could serve the same objectives. In this context, it is important that the interests and views of all parties concerned (producers, consumers etc.) are identified and adequately taken into account. While considering policy changes, policy makers should be fully aware of the adverse effects of existing investment prohibitions and should identify the benefits expected from foreign direct investment in services and the measures that could help ensure that such investment meets the expectations of the host country. They should, furthermore, review and implement measures that may encourage a complementarity between foreign and domestic investments in service industries.

56. If a country decides to reduce the number of industries or companies affected by total prohibitions on foreign direct investment but still wants to monitor the entry of foreign companies, it should carefully review and if necessary alter its monitoring or screening mechanisms to make sure that they are free from hidden obstacles that might continue to discourage foreign companies from investing. If a country decides to abolish prohibitive instruments, it should decide how far it intends to go with liberalization. If

the objective is to improve the efficiency of the services sector, liberalization may need to be far-reaching and may need to be preceded or accompanied by domestic regulatory reforms and other measures aimed at enhancing the competitiveness of national services producers and protecting consumers.

57. In reviewing and considering the liberalization of ownership restrictions, policy makers should consider the effectiveness of joint ventures for attaining their objectives. Specifically, the existence of conditions conducive to encouraging the transfer of technology through joint ventures should be examined. If these conditions are absent, the cost of joint ventures in terms of deterrence of foreign direct investment and other associated benefits may not be justified.

58. It should also be noted that a distinction between voting and non-voting stocks may provide the benefits of control with a smaller cost in terms of investment forgone. In monopoly and oligopolistic industries in which joint ventures are preferred, the degree of ownership may be used as a negotiating tool; a higher ownership stake could be offered to a foreign firm offering more resources or other benefits.

## Notes

1/ For a review of the emerging General Agreement on Trade in Services, see World Investment Report 1992: Transnational Corporations as Engines of Growth (United Nations publication, Sales No.E.92.II.A.19), pp. 66-69.

2/ See World Investment Report, 1991: The Triad in Foreign Direct Investment (United Nations publication, Sales No.E.91.II.A.12), pp. 15-22, for a discussion of the sectoral shift of foreign direct investment towards services.

3/ United Nations, Department of Economic and Social Development, Transnational Corporations and Management Division, foreign-direct-investment database.

4/ World Investment Directory, vol. III, Developed Countries (United Nations publication, forthcoming).

5/ World Investment Directory 1992, vol. I, Asia and the Pacific (United Nations publication, Sales No. E.92.II.A.11), p. 25.

6/ See World Investment Report, 1991 ..., pp. 21-22.

7/ Karl P. Sauvant, "The tradability of services", in World Bank and United Nations, The Uruguay Round: Services in the World Economy (Washington, D.C., 1990), pp. 114-122.

8/ Based on Transnational Corporations and Management Division, World Investment Directory, vol. IV, Latin America and the Caribbean (United Nations publication, forthcoming). During 1980-1990, foreign-direct-investment stocks in finance and insurance increased at average annual rates of 14 per cent in Brazil and 27 per cent in Chile, while foreign-direct-investment stocks in services as a whole increased at average annual rates of 10 per cent in Brazil and 26 per cent in Chile.

9/ Organisation for Economic Cooperation and Development, Banks under Stress (Paris, 1992), pp. 23-24.

10/ Ibid.

11/ Organisation for Economic Cooperation and Development, Liberalisation of Capital Movements and Financial Services in the OECD Area (Paris, 1990), pp. 59-60.

12/ Business International Corporation, Investing, Licensing and Trading Conditions Abroad, various country reports for Asia and Latin America (New York, 1990-1992).

13/ Asian Wall Street Journal, 24 February 1992.

14/ Transnational Corporations in International Tourism (United Nations publication, Sales No. E.82.II.A.9), p. 30.

15/ See Foreign Direct Investment and Transnational Corporations in Services (United Nations publication, Sales No. E.89.II.A.1), p. 114.

16/ Charles P. Kindleberger, Multinational Excursions (Cambridge, Massachusetts, The Massachusetts Institute of Technology Press, 1984), p. 54.

17/ Ibid., p. 53.

18/ Ibid.

19/ See Organisation for Economic Cooperation and Development, Trade in Services and Developing Countries (Paris, 1989), p. 20.

20/ See Surjit S. Bhalla, "India", in World Bank and United Nations, The Uruguay Round ..., pp. 188-196.

21/ See C. A. Primo Braga, "Brazil", in World Bank and United Nations, The Uruguay Round ..., pp. 197-209.

22/ Organisation for Economic Cooperation and Development, Foreign Direct Investment: Policies and Trends in the OECD Area (Paris, 1992).

23/ See Organisation for Economic Cooperation and Development, Trade in Services ..., pp. 17-18.

24/ See D. A. Germidis and C. A. Michalet, International Banks and Financial Markets in Developing Countries (Paris, Organisation for Economic Cooperation and Development, 1984).

25/ Government Policies and Foreign Direct Investment, UNCTC Current Studies, Series A, No. 17 (United Nations publication, Sales No. E.91.II.A.90), p. 8.

26/ See, for example, Technology Acquisition under Alternative Arrangements with Transnational Corporations: Selected Industrial Case Studies in Thailand, UNCTC Current Studies, Series A., No. 6 (United Nations publication, Sales No. E.87.II.A.14), pp. 47-48; and Frances Stewart, "Technology transfer for development", in Robert E. Evenson and Gustav Ranis, eds., Science and Technology: Lessons for Development Policy (Boulder and San Francisco, Western Press, 1990), p. 316.

27/ Frances Stewart, loc cit.

28/ Ibid.

29/ United Nations, "Transnational service corporations in Morocco, Tunisia and Algeria", 7 June 1991, unpublished mimeograph.

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